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SUBJECT: KAZAKHSTAN: TRIALS, TRIBULATIONS, AND TRIUMPHS OF THE
POWER BUSINESS

REF: (A) ASTANA 0251 (B) ASTANA 0419 (C) ASTANA 0555

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11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: On May 6, AES Vice President Mike Jonagan (protect throughout) met with Energy Officer and a visiting delegation from the Department of Energy's Office of Russian and Eurasian Affairs to discuss the state of Kazakhstan's power sector and AES's future plans in the region. Jonagan said the way to increase energy efficiency and attract infrastructure investment is to establish market-based tariffs, rather than implement the fixed tariff schedule proposed by the government. He also commented on the recent power outages in Almaty, the performance of the Kazakhstan Electricity Grid Operating Company (KEGOC), alternative energy options, and theft and corruption in the power sector. Despite the difficulties of doing business in Kazakhstan, Jonagan said AES has been successful and is pleased with the performance of the companies it manages. On a personal note, Jonagan said that local authorities opened a new civil lawsuit against him and he confided that he will move to London in September to oversee AES's operations in Ukraine and Kazakhstan. END SUMMARY.

PUTTING A PRICE ON POWER

13. (SBU) According to AES Vice President Mike Jonagan, raising tariffs for electrical power would attract much-needed investment, with little negative social impact. "The government has this irrational fear that if tariffs are increased, there would be riots in the streets. I just don't see that happening," he said. He acknowledged that increasing the price of electricity during a recession would not be an easy, or popular, decision. But Jonagan said profit margins in Kazakhstan's power sector are thin and he made a convincing argument that capping tariffs, as the government proposes, would further constrain investment in network infrastructure.

"THE NETWORK IS FALLING APART"

¶4. (SBU) Jonagan said the power grid is in desperate need of repair and rehabilitation. "The network is falling apart in front of us," he said, adding that only an increase in tariffs could convince companies to invest in the power grid. "If we were at five or six cents a kilowatt hour, life would be so good," he said. (NOTE: Tariffs in East Kazakhstan oblast are now approximately five tenge (approximately 3 cents) per kilowatt hour. END NOTE). Jonagan said that Kazakhstan's power network is in bad shape, but "it will not suddenly collapse all at once." He said that if companies started investing in infrastructure now, then within five years, the grid would be fully functional and reliable. "The only solution to improve the distribution network is to raise tariffs. Higher tariffs will mean greater conservation, fewer technical losses, and increased investment in the grid."

ALMATY BLACKOUTS

¶5. (U) This year alone, there have been four major power outages in Almaty, including two blackouts in May and one on April 15 that left 70 percent of the city's residents without power. The cause of the blackouts has been attributed to ageing infrastructure, including faulty 110 kV power transmission lines. On May 6, following the most recent power outage in Almaty, the region's deputy governor, Yerbol Shormanov, publicly demanded that the Samruk-Kazyna National Welfare Fund take immediate action to ensure a safe and stable power supply to the former capital. Samruk-Kazyna owns the power distribution company Alatau Zharik Kompanias, which is responsible for supplying electricity to Almaty. "They have to hold the electric company accountable," the deputy governor said. On May 8, Samruk-Kazyna announced that it had fired Serik Ospanov, head of Alatau Zharik Kompanias, and appointed his deputy to run the company in the interim.

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¶6. (SBU) According to AES's Mike Jonagan, "the power situation in Almaty is a disaster." He said the problem is a collective failure to maintain and upgrade the network, which is made more difficult by the fact that power is always in demand in Almaty; there is no down time. "The summer peak is the same as the winter peak," Jonagan said, "and they cannot switch the load to a partially utilized transformer. They simply don't have that luxury. There is not enough power supply to meet consumer demand in the south and the delivery infrastructure is simultaneously used to generate heat, further taxing the system." (NOTE: According to Mariyash Zhakupova, former senior technical advisor to USAID's first Regional Electricity Market Assistance Program (REMAP), "the Almaty blackouts show that the Central Dispatch Center is not working effectively and the balancing market is not functioning. If it were, that would aid in scheduling off- and on-peak generation." END NOTE.)

ENERGY EFFICIENCY

¶7. (SBU) Jonagan said that there are important and immediate gains to be made in improving energy efficiency in Kazakhstan. For example, he said that AES offered to install high efficiency transformers and replace incandescent light bulbs with compact fluorescent lamps, which he claimed would reduce energy consumption by 30 percent. Unfortunately, according to Jonagan, the former governor of East Kazakhstan oblast, Zhanybek Karibyanov, was not interested in this demonstration of corporate social responsibility. "He said he would rather we built him a park," Jonagan said.

RENEWABLE ENERGY

¶8. (SBU) Kazakhstan has great potential for harnessing wind and solar power, according to Jonagan. He said that wind power would be particularly attractive at a 100 MW increment for localized markets like Almaty, which could serve to reduce the demand for baseload power. However, Jonagan was not optimistic about the development of renewable energy sources in Kazakhstan, mainly due to the country's abundance of cheap hydrocarbon resources. To jump start the renewable energy industry in Kazakhstan, he said, the government would need to introduce a "green tariff, and there is no appetite

for that, not in a down market." He added that Kazakhstan's power plants would rather burn oil and mazut than invest in wind power, since wind power would cost 14 cents/KWH compared to current much lower thermal and hydro-power rates. "Right now, wind is not an attractive alternative," according to Jonagan. "AES has a lot of wind turbines and we offered to bring our expertise and our equipment to Kazakhstan, but when we spoke to Samruk-Kazyna, they just were not interested."

STEALING ELECTRICITY

¶9. (SBU) According to Jonagan, theft is a pervasive problem throughout the power sector. Surprisingly, he said some of the worst offenders have been among their most affluent customers, including prosecutors, parliamentary deputies, and energy officials, who feel they are entitled to special treatment. Jonagan said it is also common practice for household consumers to tamper with electricity meters, where they exist. Alternatively, if the meter is located inside, consumers sometimes lie to the electric company about usage volumes. Jonagan said that existing meters are extremely old, are not being replaced, and are slowing down, making it more difficult to establish market prices for power. Sometimes, stealing electricity is simply done for expedience, as Jonagan discovered to his chagrin. "I was stealing electricity myself and didn't know it," he confessed. "The construction company that built my apartment tapped into an adjacent power line illegally and wired the entire building. When I found out what they had done, I had to move to a new apartment. That would not have looked good in the newspapers."

NO METER, NO BILL

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¶10. (SBU) In 2007, according to Jonagan, KEGOC began to introduce real-time metering at the grid connection points on the Kazakhstani-Russian border, but the distribution companies resisted this because they understood that it would expose their price manipulation practices. As Jonagan explained, "If there is no meter, you can't send a bill." He said that at the moment, Kazakhstan's wholesale customers are not compelled to submit an accurate schedule of their power consumption. They are allowed simply to add up the total volume of electricity used per day and prorate it according to an average daily cost per kilowatt hour, rather than paying higher prices for use during peak times, as one would expect.

KUDOS FOR KEGOC

¶11. (SBU) Jonagan said that KEGOC is doing a first class job managing the network. He said the larger power transmission lines, from 220-500 kV, look very good. It is clear to Jonagan that KEGOC has invested in these lines and he said they provide "close to Western quality transmission." The economic crisis, however, is likely to affect KEGOC's continued ability to maintain and upgrade the power grid. (NOTE: On May 7, KEGOC adjusted its 2009 revenue projections down by 14 percent, or 6 billion tenge (approximately \$40 million), due to an 18 percent drop in power transmission services. END NOTE.)

AES WOULD LIKE TO REMAIN IN KAZAKHSTAN

¶12. (SBU) AES owns two combined heat and power plants and has concessions on two hydropower plants through 2017, in addition to the management contracts for power distribution networks in East Kazakhstan. Jonagan said he was pleased with the recent performance of AES assets, despite the economic downturn. For example, he said that the company's collection rates are improving as customers pay off old debts. "For the past several months, we have averaged greater than 100 percent collections," Jonagan said. He also reported that Berdybek Saparbayev, newly appointed governor (akim) of East Kazakhstan oblast, recently reviewed AES's performance and decided to extend its contract for another five years, through February 2014, at a fixed fee of \$100,000 per year. Jonagan said proudly, "The new akim understood that we would operate the company in a transparent, commercially sound manner. That showed real

leadership. Those guys usually come in and they bankrupt the oblast power companies by charging four or five times the cost of producing electricity and padding the subcontracts. This guy is different."

WHO WILL GET THE HYDROS?

¶13. (SBU) Toward the end of the meeting, Jonagan disclosed that local authorities in Almaty recently opened a new civil lawsuit against him. He said the local government is still pursuing back taxes from a trading company, long-defunct, that AES established years ago. Jonagan was named in the suit because he is still listed as the responsible corporate officer for the company, which he explained was the only way to secure his work permit when he first arrived in Kazakhstan. Jonagan said he is not overly concerned by the legal action, but he confided that he will move to London in September to oversee AES's operations in Ukraine and Kazakhstan. He also said AES may soon be forced to part with its prized assets, two hydropower plants in East Kazakhstan that are now comfortably profitable. "When we took on the concession for these assets," Jonagan said, "they needed a lot of work. Now, hydropower is very attractive and all the guys are fighting over the pretty girl." He then struck an ominous note: "Certain elements have made it clear that they are going to get the hydros from us. I almost don't care anymore. They're not exactly strategic assets. If we get a fair offer, we'll sell them. But we would at least like to recoup our initial investment." When asked whether AES will continue to do business in Kazakhstan, Jonagan replied, "We'll stay here as long as we don't get run off."

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